

**Assistant Commissioner of Income Tax vs. Celerity Power LLP**

**[2018] 100 taxmann.com 129 (Mum ITAT)**

**No taxable capital gains arises on conversion of a private company into LLP at book-value, notwithstanding non-compliance with the conditions given in section 47(xiiib) of Income Tax Act, 1961**

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**1. Facts:**

- a. On 28-9-2010, Celerity Power Pvt. Ltd. (for short 'the Company') was converted in an LLP, namely, Celerity Power LLP (for short 'the LLP') as per Section 58 of Limited Liability Partnership Act, 2008 (short for 'LLP Act'). In other words, the Company transferred its entire undertaking with all its assets and liabilities to the LLP on 28-9-2010.
- b. Section 47(xiiib) of the Income-tax Act, 1961 (short for 'the Act') provides for specific exemption from capital gains tax in case of such conversion, subject to satisfaction of various conditions provided therein. In the present case, admittedly, one of the conditions under said section was not satisfied. Namely, the turnover of the Company exceeded the threshold limit of Rs. 60 lakhs, as required under said section.
- c. Accordingly, the LLP's case was selected for scrutiny u/s. 143(2) the Act and the Assessing Officer (for short 'the AO') added to the total income of the LLP under the provisions of section 47A of the Act, capital gains amounting to Rs. 1.76 crores allegedly arising on conversion of the Company to the LLP.
- d. The AO rejected the LLP's contention that on conversion of a company into LLP, there was no 'transfer' of capital assets and accordingly, the provisions of capital gains tax do not apply even if the conditions under section 47(xiiib) are not complied with. Alternate claim that since the assets and liabilities were recorded at book value, even otherwise no capital gains would arise was also rejected. Further, the claim of the LLP to carry forward the brought forward losses of the Company, amounting to Rs. 5.79 crores, was also denied. Besides, claim for deduction under section 80-IA of the Act was also denied on the technical ground that Form 10CCB was not filed by the LLP along with the ITR.

- e. On appeal, the CIT(A) gave part relief to the assessee. Both revenue and as well the assessee challenged the order of the CIT(A) before the Hon'ble ITAT.

## **2. Issues under consideration before the Hon'ble Mumbai ITAT**

Following issues were raised before the Hon'ble ITAT:

- a. Whether conversion of the Company into the LLP can be regarded as 'transfer' or not?
- b. If the conversion of the Company into the LLP is to be regarded as transfer, whether there can be any capital gains liability, where the assets and liabilities are vested at book value?
- c. Whether the LLP is liable to pay capital gain tax for transfer of assets by erstwhile Company u/s. 47A(4) of the Act, where exemption under section 47(xiii b) was not claimed by the company/LLP?
- d. Whether brought forward losses of the erstwhile Company can be set-off by the LLP u/s. 72A (6A) of the Act?
- e. Whether deduction u/s 80-IA of the Act can be claimed by the LLP even though Audit Certificate in form 10CCB was not submitted alongwith ITR as required u/s 80-IA of the Act.

## **3. Revenue's contentions:**

- a. As the Company's turnover during F.Y 2009-10 was Rs 8.87 crores, the condition prescribed by sub-clause (e) of Section 47(xiii b) of Act (viz. turnover must not exceed Rs. 60 lakhs during any of 3 previous years prior to the previous year in which the transfer/conversion takes place) is violated. Hence, the transfer is not an exempted transfer, and it will attract capital gains tax.
- b. Since the condition under sub-clause (e) of Section 47(xiii b) of Act is violated by erstwhile Company,
  - i. The LLP is required to pay capital gain tax on transfer of the assets to the LLP u/s. 47A(4) of the Act, and

- ii. The LLP cannot set-off brought forward loss of the erstwhile company, as Section 72A(6A) of the Act permits benefits of set-off only in cases where all conditions prescribed by Section 47(xiiiib) of the Act are complied with.
- c. Deduction u/s. 80-IA of the Act is not allowable as Audit Certificate in Form 10CCB was not submitted alongwith ITR, as required under Section 80-IA of the Act.

#### **4. Assessee's contentions**

- a. Conversion of a company into a LLP results in statutory vesting of assets and liabilities and not 'transfer'. On vesting of all the properties statutorily in the LLP, the cloak given to the company is replaced by a different cloak and the same company is now treated as a LLP, after a given date. Reference was made to Section 58(4) and the Third schedule to the LLP Act to demonstrate that on conversion from a private limited company to LLP, all tangible and intangible property of the company is transferred to and stands 'vested' in the LLP. As per Clause 6(b) of the 'Third schedule', on the grant of registration as LLP under Clause 4, all the tangible, intangible property including assets, interests etc. stands vested in the LLP without any further assurance, act or deed.
- b. Reliance was placed on the decision of the Hon'ble Bombay High Court in CIT vs. Texspin & Engg. Works [(2003) 263 ITR 345], wherein it has been held that there was no 'transfer' of assets on conversion of a firm to a company under Part IX of the Companies Act, 1956. Further reliance was placed on the decision of the Hon'ble High Court of Bombay in the case of CIT v. Umicore Finance Luxemborg [2016] 76 taxmann.com 32 (Bom) to contend that, even otherwise, Section 47(xiiiib) r.w Sec. 47A cannot be construed to read a fiction, to the effect that the income which is not liable to be taxed as capital gains can be deemed as 'capital gains'.
- c. It was also contended that in the transaction of conversion, no consideration is involved, and hence, the machinery provision for computing the capital gains is rendered as unworkable. Alternatively, even if there was a 'transfer', then what was transferred was the 'undertaking' which had no determinable cost of acquisition, therefore, on the said count also no 'capital gain' was chargeable in the hands of the assessee.

- d. As regards the contention of the department that section 47A(4) was applicable in the present case, it was argued that section 47A(4) of the Act can be invoked only when exemption under section 47(xiii b) is first claimed by the assessee and there has been subsequent violation of the conditions mentioned therein. In given case, erstwhile Company has not claimed exemption u/s 47(xiii b) of the Act. Hence, there is no question of withdrawal of benefits of said exemption by invoking section 47A of the Act.

## 5. Held

- a. On the main contention that conversion of a company into LLP does not result in transfer, the Hon'ble Tribunal took a negative view. Referring to the provisions of section 47(xiii b) and the Memorandum explaining said provisions, it took a view that transaction involving conversion of a private limited company or unlisted public company to a LLP as contemplated in Sec. 47(xiii b) would be a 'transfer', however, the same on cumulative satisfaction of conditions (a) to (f) of the *proviso* to Section 47(xiii b) would not be chargeable to 'capital gains' under Section 45 of the Act.
- b. Decision of the Bombay High Court in Texpin's case (*supra*) was distinguished on the basis that vesting of a firm's assets to a company under part IX of the Companies Act, 1956 is differently placed from conversion of a company's assets into a LLP under the LLP Act, since Part IX only talks about vesting of assets and liabilities whereas the LLP Act talks about both transfer and vesting of assets and liabilities upon conversion. However, on the issue of computation of capital gains, the Hon'ble Tribunal held that computation is an integral part of chargeability under the Act, as held by the Hon'ble Supreme Court in the case of CIT v. B.C Srinivasa Setty [1981] 128 ITR 294 (SC) and Navin Jindal & Ors. v. ACIT [2010] 320 ITR 708 (SC) and by the Hon'ble Bombay High Court in the case of Texspin (*supra*). Accordingly, since upon conversion, the assets and liabilities of the erstwhile private limited company had got vested in the assessee LLP at their 'book values', a fact which has not been negated, it was held that such 'book value' could only be regarded as the 'full value of consideration' for the purpose of computation of 'capital gains' u/s. 48 of the Act.
- c. It was accordingly held that though there was a transfer of capital assets from the erstwhile private limited company to the assessee LLP by virtue of the provisions of

section 47(xiiib), however, as the difference between the consideration and the cost of acquisition was Nil, therefore, while computing the 'capital gains', the machinery provision was rendered as unworkable.

- d. Further, contention of the assessee was accepted that section 47A(4) of the Act cannot be invoked in the case, as no benefit of exemption u/s. 47 (xiiib) of the Act was claimed by the erstwhile Company.
- e. However, on the issue of carry forward of losses in the hands of the LLP, the Hon'ble ITAT held that in view of specific provisions of section 72A(6), since the conditions under section 47(xiiib) were not satisfied, said carry forward would not be allowable to the LLP.
- f. Claim for deduction under section 80-IA was allowed and it was held that non-submission of Audit Certificate in Form 10CCB alongwith ITR as required u/s 80-IA of the Act was procedural defect, which can be rectified during assessment proceedings.